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Date

June 21, 1984

Surname

EIN: [REDACTED]

DO: [REDACTED]

MAY 17 1984

Ladies and Gentlemen:

We have considered your application for recognition of exemption from federal income tax under section 501(c)(12) of the Internal Revenue Code.

The information submitted discloses that you were organized on [REDACTED], as a mutual corporation under chapter [REDACTED] of the revised Code of [REDACTED]. Your stated purpose is to provide your members with domestic water service for residential use and to provide such service at cost, on a mutual basis, and without profit.

Article 2.1.1 of your bylaws provides that the owner of, or in the case of property subject to a real estate contract, the purchaser of any portion of the real property described in Exhibit A of the Articles of Incorporation ([REDACTED]) shall be eligible for membership, and membership in this corporation shall be restricted to those owning or purchasing a portion of the [REDACTED].

Each applicant for membership shall subscribe for that number of shares or fractional shares of the common stock of the corporation which is equal to the number of acres or fractional acres that are owned or being purchased by the applicant. Article 2.12 of your bylaws provides that each member shall be entitled to one vote or a fractional vote for each share or fractional share of common stock owned off record by him.

As shown by your stock subscription record, [REDACTED] still own [REDACTED] acres ([REDACTED]). The total development consists of [REDACTED] acres. At present, [REDACTED] are entitled to vote and have [REDACTED] votes; this is the number of shares they have paid for, as shown in the stock subscription record. You advise that the land is being developed in [REDACTED] acre parcels (except for far smaller parcels at the northeast corner and the [REDACTED] acres property [REDACTED] intend to retain.

Section 501(c)(12) of the Code provides exemption for benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations, but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

To be exempt under section 501(c)(12) of the Code, an organization must be a true mutual or cooperative organization. However, the organization may transact business with non-members provided that the income collected from non-members does not exceed 15 percent of the organization's income.

Section 1.501(c)(12)-1 of the Income Tax Regulations provides, in part, that an organization may be entitled to exemption although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

Although the regulations under section 501(c)(12) of the Code do not define a "mutual" organization, certain fundamental principles are common to all such organizations. These organizations have been defined generally as those that are organized for the mutual benefit of their members. Their distinguishing features are democratic control and voting, the distribution of economic benefits on an equal basis or in proportion to the use made of the association's facilities, limited return on capital, and the fact that they do most of their business with their own members.

Of equal importance to the concept of the equal distribution of economic benefits or in proportion to the use made of the organization's facilities to qualification under section 501(c)(12) of the Code is the principal of democratic control of the organization by the members.

In the Case of Keystone Automobile Club Casualty Company et al v. Commissioner, 122 F 2d 886 (3rd Cir. 1941), cert denied, 315 U.S. 841 (1942), the court recognized that democratic control by the members is one of the basic characteristics of all mutual organizations. Consistent with this fundamental principle it is necessary that an organization be democratically controlled in order to qualify for exemption under section 501(c)(12) of the Code. Democratic control requires that members as a group have a right to vote, a voice in the management, and the right to select officers. Any substantial departure from these fundamental right will prevent the organization being considered democratically controlled.

Although all your members are entitled to vote on matters affecting your operation, the essential characteristics of democratic control that is necessary for mutual operation is not present since your developer, who expects to retain [REDACTED] shares of stock (representing [REDACTED] acres), still holds [REDACTED] acres and, therefore, he or a subsequent purchaser could, through their potential voting power, effectively dominate and control your activities and operations while you anticipate that the property will be divided and sold in [REDACTED] acre parcels and that, in effect, most shareholders will have [REDACTED] votes, it is unclear at this time that this will be the case. In addition, it is arguable that democratic control is absent at the present time since the developer has (and will continue to have) at least [REDACTED] votes while the [REDACTED] other current members have [REDACTED] or fewer votes. Given the [REDACTED] small membership of the organization, at present, there is the potential that the majority shareholder could effectively dominate and control your activities and operations.

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EP/EO Division
Seattle, Washington

[REDACTED]

Thus, we conclude that you are not operated on a true mutual basis and therefore, do not qualify for exemption under section 501(c)(12) of the Code.

You are required to file federal income tax returns on Form 1120.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted in duplicate within 21 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney Form 2848 and otherwise qualify under our Conference and Practices requirements.

If we do not hear from you within 21 days, this ruling will become final and copies of it will be forwarded to the District Director, Seattle, Washington. Thereafter, any questions about your federal income tax status or the filing of tax returns should be addressed to that office.

Sincerely yours,

cc: [REDACTED]

cc: [REDACTED]

[REDACTED]
[REDACTED]
Chief, Exempt Organizations
Rulings Branch

[REDACTED]